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CROSS-COUNTRY ANALYSIS OF CORPORATE GOVERNANCE CODES IN THE EUROPEAN UNION

Aleš Kubíček,
University of Economics,
Prague, Czech Republic,
E-mail: ales.kubicek@vse.cz

Petra Štamfestová,
University of Economics,
Prague, Czech Republic,
E-mail: petra.stamfestova@vse.cz

Jiří Strouhal,
Škoda Auto University Mladá Boleslav,
Mladá Boleslav, Czech Republic,
E-mail: ystrouhal@is.savs.cz

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ABSTRACT. The purpose of this paper is to analyse corporate governance codes in the member states of the European Union (EU) and to examine to what extent is their contents shaped by the EU. Building on study of diffusion in organizational settings, we examine whether exogenous forces in the form of the European Commission recommendations have impact on the contents of corporate governance codes or contents is driven by domestic stakeholders representing endogenous forces.
Furthermore, we contribute to limited research analysing evolution of corporate governance codes and we examine how compliance with the European Commission (EC) has changed over time. Our findings suggest a significant strengthening of codes' quality across member states and convergence tendency to international best practices. However, we are not able to affirm that the European Commission recommendations were that certain exogenous force to shape national governance codes.

JEL Classification: G34

Keywords: Corporate Governance, Corporate Governance Codes, the European Union.

Introduction

Corporate governance codes (further – governance codes) are an important area of international corporate governance as they are designed to provide firms with guidelines how to set corporate best practice. Unlike other forms of regulation belonging to hard law, a governance code is a "set of best practice recommendations regarding the behaviour and structure of the board of directors of a firm". Since it consists of recommendations on how company may efficiently and transparently adjust its governing body in order "to address deficiencies in the corporate governance system" (Aguilera, 2004, p. 419), a governance code is considered an element of soft law. The contents address the key issues affecting the relationship between owners and managers in order to eliminate information asymmetry and improve transparency in company's functioning (Cuomo *et al.*, 2015).

The code issued in the Unites States in 1978 was the first of its kind followed by a code from Hong Kong in 1989 and Ireland in 1991. However, the number began to grow rapidly after establishing the first European code so-called the Cadbury Report issued in the United Kingdom in 1992, which became a model for many other national and international codes in the following years. The report recommends implementing the code for listed companies on the principle of "comply or explain", which became the cornerstone of governance codes further on. This approach allows a company to deviate from the recommendations of the code, but it must satisfactorily explain the reason of such behaviour. The principle has spread to other countries and this manner of governance reporting is also recommended by the OECD Principles of Corporate Governance (OECD, 2004).

Until the end of year 2014, their figure has grown to 91 countries with at least one code and the total of 345 codes (91 original codes and 254 revisions) (Cuomo *et al.*, 2015). Moreover, international organizations such as the Organization for Economic Cooperation and Development, the World Bank or the United Nations also have their own versions of codes.

In this paper, we will analyse the governance codes of the European Union member states and examine to what extent they comply with international best practice. For the purpose of this study, we consider the EC recommendations as best practice. We examine whether contents of national codes are influenced by these recommendations as exogenous force or are driven by domestic stakeholders representing endogenous forces and how the contents evolve over time. The remainder of the paper is organised as follows. First, we discuss theoretical background of governance codes and present state of the art in the research area. Then we describe the corporate governance framework for the European Union. Afterwards, we describe the methodology, individual findings and their further analysis. Finally, we discuss conclusions and provide suggestions for further research.

1. Literature Review of Governance Codes

Research of governance codes has emerged in the wake of the first wave of codes at the end of 1990s. Existing research is to a large extent linked with comparative corporate governance, which investigates the differences in governance systems among countries and analyses the level and trends of either convergence or divergence between systems over time and space (Aguilera and Jackson, 2010; Hopt, 2011). Codes have become an important tool for such comparisons because their form and contents varies considerably across the world. These particular differences and similarities may help explain the existing diversity in the practice of corporate governance. Research essentially examines codes in different countries and analysing how codes diffuse and the extent to which they comply with the international best practice. Within the domain of comparative corporate governance, the contribution of governance codes in the explanation of the differences and similarities across countries can be regarded from perspectives of various scholarly disciplines (Aguilera and Jackson, 2010; Fissi *et al.*, 2013; Romolini *et al.*, 2015).

Similarly to corporate governance research in general, disciplines of economics and law continue to represent the predominant perspective, which regards a firm as a nexus of contracts (e.g. Jensen and Meckling, 1976). Corporate governance building mainly on agency theory (Shleifer & Vishny, 1997) explores the mechanisms set up to mitigate agency problem. Among these typical governance mechanisms, we can name the market for corporate control, accounting and audit rules, ownership structure or board composition. A governance code offers firms to improve their governance settings beyond hard law regulation. Its presence or absence, as well its contents is compared across countries in order to examine how to minimize agency costs.

Aguilera and Cuervo-Cazurra (2009) return to the governance codes in 2009 and review their recent global development and also propose wide open field. Authors stress that the existing research is lacking in several areas. For our study two assumptions are relevant. Firstly, research has not considered the identity of the issuer and their influence on code content and enforcement. The different types of issuers have different objectives and therefore it is desirable to take issuer´s nature into consideration while comparing various codes. Secondly, it is necessary to consider the perspective of time since issues of corporate governance evolve that means that governance code should reflect these changes.

Hermes *et al.* (2006) employ Aguilera's and Cuero's proposal of endogenous and exogenous forces in practice. Authors compare the compliance of the codes of European Union countries and the European Commission suggestions recommended in the Communication COM – 284 published in 2003. Similarly to Aguilera and Cuervo-Cazurra, authors investigate how and to which extent the contents of governance codes are influenced by these forces. The following year, Hermes *et al.* (2007) extend the sample by the new member states from Eastern Europe. Results show that the Czech and Slovak codes comply with 16 and 15 respectively of the 18 recommendations that represent highest congruity among all countries.

Zattoni and Cuomo (2008) also follow up mentioned review and examine main drivers of code adoption in different legal systems. According to their findings using a sample of 60 countries, civil-law countries issue codes later than in common-law countries. Furthermore, codes are less frequently updates and the recommendations are more general. As for main driver, civil-law countries issue a code as a legitimacy effort, rather than an attempt to improve efficiency for national corporate governance.

Governance codes are employed in corporate governance research also in different ways as we present in the context of European corporate governance. Stefanescu *et al.* (2012) use governance codes enforceability at the EU level to examine required transparency and disclosure based on an identity of issues and country's legal regime in relation to OECD principles' recommendations. Authors conclude that level of disclosure is correlated with an identity of issuer when the highest level of disclosure is required by codes issued in collaboration of several economic institutions and stock exchanges, while the lowest level is required in codes by industry or trade associations. Authors suggest that it shows that these issuers likely defend their own interests in a way to disclose as little information as possible. Cicon *et al.* (2010) use Latent Semantic Analysis to examine governance codes of 23 EU state members in order to determine code theme. Authors categorize five general themes which importance substantially varies across countries. They also recognize that an identity of the code issuer is an important factor influencing the code's key theme and theme importance changes over time in different measure across issuer type.

Another interesting contribution is the issue of convergence and divergence of continental codes towards an Anglo-Saxon model of corporate governance. Authors suggest that national corporate governance practices are evolving beyond the bounds of historical context as they classify four codes clusters. Empirical findings confirm that some aspects of these codes are truly converging to UK practices while others diverge. The issue of convergence or divergence in the area of corporate governance is crucial for the EU in effort to harmonize existing governance practice in the individual member states. Prior evidence differs and according to Lazarides and Drimpetase (2010) it is necessary to ask whether the global convergence in the only system is desirable outcome. Generally, we distinguish between Anglo-Saxon and continental European system which address difference key themes. In the Anglo-Saxon system, the main issue is the relationship between manager and owner, while in continental system it is to protect interests of minority shareholders. According to authors, so long these differences exist, legal converge may cause more of a problem than a solution.

Although the economic and law theories headed by the agency theory have greatly contributed to our understanding of cross-national diffusion in corporate governance practices (Aguilera and Cuervo-Cazurra, 2009), many issues remain unresolved.

Sociology brings another perspective that is essential in examination of cross-national diversity existing in corporate governance. It is evident that corporate governance is not solely based on economic theory but is firmly embedded in the national context. Cultural, social and political aspects play an important role in the way they shape a form of the national regulation (Licht *et al.*, 2007). The cultural aspect has been included in the interpretation of differences across countries within the domain of comparative corporate governance since the publication of Hofstede´s cultural values framework in 1980 (Hofstede, 1980). This framework has been frequently utilized by business and psychology scholars and significantly influenced existing knowledge of cross-cultural research (Kirkman *et al.*, 2006). A study built on diffusion and cultural dimensions theory by Haxhi and van Ees (2010) examine how cultural dimensions influence adoption and contains of national codes. Their results show that individualistic cultures have a tendency to issue more codes than collectivistic ones. In cultures with high power distance the first national code is usually published by normative institutional (the government or the professional association), while in cultures with low power distance it is more likely the stock exchange or the investors association. Authors comment that their results diverge from prior findings of Aguilera and Cuervo-Cazurro (2004), since they have not found evidence that legal system has any influence on the code adaption whatsoever.

But although Hofstede's cultural dimensions still remain the predominant measures, some critics have pointed out that they are severely outdated (Sivakumar and Nakata, 2001) or even incorrect (McSweeney, 2002). On the other hand, institutional theory in sociology, to be more precise "new institutionalism" (DiMaggio and Powell, 1991) has so far provided considerable contribution to corporate governance (Aguilera and Jackson, 2010). While the approach shares with older cultural theories elements of social norms and organizational legitimacy, further emphasizes a sociological view of institutions. An institutional approach suggests that the corporate governance setting reflects political process of the state government (Fiss, 2008). This is in a direct contrast with contractarian framework emerged from economic-law perspective that such setting arises naturally from a collection of contracts between different parties. Although contractarian framework currently represents a dominant theoretical approach on understanding governance arrangements, culturally and politically based institutional theory provides a vital alternative, particularly in the case of the diffusion of corporate governance practices. The research focuses on the prerequisites of successful cross-national diffusion. The institutional perspective emphasizes the fact that the practice does not diffuse into an institutional vacuum, but into an existing cultural, social and moral environment. Enrione *et al.* (2006) investigated the institutionalization and evolution of governance codes from the perspective of the new institutional theory of organizations and confronted existing findings of the dominant agency theory. Authors derive that the governance codes are mainly issued by regulators in order to avoid scandals and support their legitimacy. These issuers are "carriers of normative pressures" and thus the institutionalization process is shaped by the societal context (Enrione, 2006, p. 971).

Cuomo *et al.* (2015) in the recent literature review on governance codes state that research increases constantly over time but there are still opportunities for better understanding of governance codes, particularly in employing other theoretical perspectives beyond agency theory.

2. European Union and Corporate governance

Corporate governance in the European Union is very diverse and system basically varies from country to country. We can find here representatives of one-tier, two-tier governance model as well as hybrid ones. Naturally, governance model is not only a distinguishing aspect of individual countries. Historical development, the state of the economy as well as culture and other elements are reflected in current corporate governance practice. Similarly, to the rest of the world, the issues of corporate governance began to be discussed in EU at the turn of the century.

Corporate governance has been primarily focused on listed companies and its regulation is treated with a combination of hard and soft law. Hard law is in the EU represented as directives that may affect corporate governance and require from member states to change corporate laws. Unlike directives, recommendations are not legislative acts of the European Union and therefore it is up to each member state to decide whether to apply them into their national codes in order to improve existing governance practices. Hence, a governance code, as a set of recommendations, based on a principle "comply or explain" belongs to soft law regulation.

In 2003 the European Commission published Communication to the European Parliament and the Council, COM-284 (European Commission, 2003) named "Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward". It was the first initiative in this area at the EU level. One of the reasons was the forthcoming EU enlargement to 10 new member states in the following year, which would create enormous internal market consisted of states with different level of economic development and legislation.

This communication presented an action plan suggesting to improve corporate governance practice in member states in three general areas: (i) enhancing corporate governance disclosure, (ii) strengthening shareholder´s rights, and (iii) modernising the board of directors (COM 284).

In accordance with the established objectives EC published in following years several subsequent recommendations which cover critical areas of corporate governance in more detail. The first commission recommendation from 2004 (2004/913/EC) addresses the remuneration of directors of listed companies and significantly broaden the previous suggestions for modernising the board of directors in COM-284 into the separate sets of recommendations. The second set of recommendations on the role of non-executive or supervisory directors of listed companies and on the committees of the board (2005/162/EC) followed in 2005. This document lays down rules on the independence of directors, since this mechanism commonly suffers from inconsistency of definition across the world and thus shareholders' expectations of adequate monitoring efficiency may not be fulfilled. EC also recommends that companies set committees on the board and emphasizes their role. The last, two sets of recommendations (2009/384/EC and 2009/385/EC) published during the action plan is designed to complement the preceding two documents and respond to business practice tainted by global financial crisis (Kirkpatrick, 2009). Study of its origin has revealed that remuneration structures of board and executive members have become excessively complicated over the last years, too much short-term oriented and mostly not justified by performance.

For our analysis, we organize all four documents into the list of individual recommendations. We will focus on European Commission soft law incentive (in the form of discussed recommendations) which has set a long- term objective to modernize and improve corporate governance in the EU.

3. Theoretical Framework and Research Methodology

Aguilera and Cuervo-Cazurra (2004) in their seminal article examine the mechanisms driving the worldwide diffusion of governance codes. Building on study of diffusion in organizational settings, the adoption of new practice is linked with either efficiency or legitimation effects (Strang and Soule, 1998). According to Aguilera and Cuervo-Cazurra

(2004) the adoption of the code by country is based on endogenous and exogenous forces. While endogenous forces seek to enhance the efficiency of existing systems, exogenous forces seek to increase legitimation. Endogenous forces refer to domestic stakeholders who are concerned about an efficient protection of their interests and therefore demand a governance code to secure them. Exogenous forces are presented by international pressures to harmonize and legitimate their corporate governance system. Authors analyse on a sample of 49 countries the diffusion of codes and endogenous and exogenous forces influencing their development. They find that the codes are adopted mainly in countries with insufficient legal shareholder rights protection and strong impact of exogenous forces, such as presence of foreign investors, high government liberalization, or in case of the European states, the European Union.

The proposed framework is thus particularly interesting in case of Europe where exogenous forces, represented in first place by European Union institutions, may lead the harmonisation of corporate governance across all member states. Empirical findings confirm the noticeable differences between the individual codes prior 2002 resulting from differences in company laws of member states (Gregory and Simmelkjaer, 2002).

In this study, we follow reasoning of Aguilera and Cuervo (2004) and examine evolution of governance codes in the European Union. Based on study of diffusion (Strang and Soule, 1998) we consider how exogenous and endogenous forces shape contains of governance codes of the EU member states. For purpose of study, we consider the recommendations of European Commission as the international best practice and investigate the national codes' compliance with them. We examine whether contents of national codes are influenced by these recommendations as exogenous force or is driven by the domestic stakeholders representing endogenous forces.
Hence, our first research question is:

- *Do codes reflect recommendations of the European Commission as an international model of best practice?*

If exogenous forces are predominant, we can expect convergence among European governance codes. On the contrary, if endogenous forces representing domestic interests prevail over harmonisation of voluntary governance codes, we will observe divergence among codes. Theoretically, harmonisation in the form of *action plan* can thus serve as potential evidence for the influence of exogenous forces that has led to changes in the codes in following years.

Another objective of this work is to contribute to limited research analysing how governance codes develop over time and literature reviews call for further research (Aguilera, 2009; Cuomo *et al.*, 2015). The literature review revealed that only few studies argue that corporate governance issues evolve and so must governance codes. Due to today's turbulent environment, corporate governance problems are continuously changing hand in hand with other aspects of business practice. Therefore, it is necessary to cover these transitions in a governance code to provide companies with an adequate model of best practice.

Our second research question is:

- *Do governance codes of member states follow best practice and develop over time?*

In this study, this evolution is reflected in recommendations proposed by European Commission that are supposed to deal with current, but ever-changing problems. A governance code as a soft law instrument is convenient form of flexible reaction allowing rapid adoption at the national level.

The purpose of this paper is to investigate concordance between existing governance codes of EU member states and recommendations issued by European Commission. Our analysis is divided to two steps according to posed research questions.

First, we compile a list of recommendations from Commission recommendations which were published during the ten years of existence of action plan presented in communication COM-284 by the European Commission published in 2003. European Commission reacted on the international development and provided three sets of recommendations in the following years which can be considered the best practice of corporate governance in the European Union.

In order to maintain a time perspective of codes' compliance with the EU recommendations and to analyse whether current codes are converging toward the united model through the suggested recommendations at the EU level, we divide the proposed suggestions of COM-284 in accordance with Hermes *et al.* (2006) into 18 priorities. This approach allows us to compare our analysis with the mentioned study and ensure comparable results. These 18 recommendations are divided into four categories corresponding with individual areas of interest:

- Enhancing Corporate Governance disclosure (recommendation 1-7);
- Institutional investors (recommendation 8-9);
- Strengthening shareholders' rights (recommendation 10-12);
- Modernising the board of directors (recommendation 13-18).

In a similar way, we compile a list of recommendations which were published in the following years. European Commission reacted on the international development and provided three sets of recommendations. Our list consists of 14 additional recommendations which are categorized into three thematic groups:

- Remuneration policy (recommendation 1-3);
- Remuneration of individual directors (recommendation 4-6);
- Role of non-executive or supervisory directors of listed companies and on the committees of the board (recommendation 7-14).

Second, we examine the codes' development in the course of time to find an answer to second research question. As we have already mentioned, we employ a study by Hermes *et al.* (2006, 2007) as the starting point for comparison. Data sample consists of 22 codes of member states which are examined in the context of 18 recommendations divided into four categories state above. The following year, authors extended the sample by the new member states from Eastern Europe. Results show that the Czech and Slovak codes comply with 16 and 15 respectively of the 18 recommendations that represent highest congruity among all countries. That is significantly more than other Eastern European countries which on average comply with a half of recommendations. These findings suggest the high level of openness of those countries to external forces, which are in this case represented by the European Union. However, in our opinion it may also indicate the fact that the European Commission was inspired by the OECD Principles of Corporate Governance as both the Czech Republic and Slovakia formed their codes with direct reference to them.

Furthermore, it is important to point out that codes analysed in their paper are on average older than 10 years and many of investigated codes were issued prior to the European Commission COM-284 and so the question, whether it is possible to observer the impact of exogenous forces in the form of EU, remains unanswered. Even if we assume that member states were prompt to follow the proposed recommendations included in COM-284, it is necessary to ask whether national code contents was revised in the following years according to individual sets of recommendations. In order to maintain a time perspective, we divide the suggestions published in communication COM-284 in accordance with Hermes *et al.* (2006) into 18 priorities.

In coding process while checking whether a code includes a certain recommendation, we look for a recommendation in a broad sense rather than exact wording. One of the reasons for this compromise is the fact that corporate governance models vary across the European

Union. Therefore, it is unlikely to believe that there is same formulation in every code across member states. All recommendations are processed in a table where a code compliance with Commission recommendation is coded as "yes"; otherwise it is a "no".

As Aguilera and Cuervo-Cazurra (2004) theorize and empirical studies presented in literature review corroborate, a type of issuer is an important factor in terms of code contents and enforceability. To ensure comparability of the individual codes, the sample consists of the 27 codes issued by the national stock exchanges until the end of 2013. This timeframe reflects the 10 year of the introduced action plan. As we mentioned above, COM-740 (2012) presents a new plan "a modern legal framework for more engaged shareholders and sustainable companies" that outlines new initiatives of the Commission in order to modernise the corporate governance framework. The code issued by stock exchange can be binding for listed companies, which must in accordance with the principle "comply or explain" announce how and to which extent comply with a respective governance code.

A sample covers 27 member states of the European Union. We have to exclude Ireland because of lack of governance code specifically designated for listed companies. Irish stock exchange recognises the UK Corporate Governance Code and the Irish Corporate Governance Annex published in 2010 is not comparable to the other codes in our sample.

4. Findings and Discussion

Results of analysis for individual recommendations are provided in the following set of Tables. For the sake of brevity, in the following part concerning 18 recommendations of COM-284, we not only discuss compliance of the latest governance codes by the end of 2013 across the EU but also comment on prior situation reported by Hermes *et al.* (2006, 2007).

Table 1. Enhancing Corporate Governance disclosure

Individual member states	1	2	3	4	5	6	7	8	9	Recommendations in compliance
1	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*
Austria	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No	7 of 9
Belgium	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	8 of 9
Bulgaria	Yes	Yes	Yes	No	No	Yes	Yes	No	No	5 of 9
Croatia	Yes	Yes	Yes	No	No	Yes	No	No	No	4 of 9
Cyprus	Yes	Yes	Yes	Yes	No	Yes	Yes	No	No	6 of 9
Czech Republic	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	9 of 9
Denmark	Yes	No	Yes	No	No	Yes	Yes	No	No	4 of 9
Estonia	Yes	Yes	Yes	Yes	No	Yes	No	No	No	5 of 9
Finland	Yes	Yes	Yes	Yes	No	Yes	Yes	No	No	6 of 9
France	Yes	No	Yes	Yes	Yes	Yes	Yes	No	No	6 of 9
Germany	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No	7 of 9
Greece	Yes	Yes	Yes	Yes	No	Yes	Yes	No	No	6 of 9
Hungary	Yes	Yes	Yes	No	No	Yes	Yes	No	No	5 of 9
Italy	Yes	No	Yes	No	Yes	Yes	Yes	No	No	5 of 9
Latvia	Yes	Yes	Yes	No	No	Yes	Yes	No	No	5 of 9
Lithuania	Yes	Yes	Yes	No	No	Yes	Yes	No	No	5 of 9
Luxembourg	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No	7 of 9
Malta	Yes	No	Yes	No	No	Yes	Yes	Yes	No	5 of 9
Netherlands	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	8 of 9
Poland	Yes	Yes	Yes	No	Yes	Yes	Yes	No	No	6 of 9

1	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*
Portugal	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	8 of 9
Romania	Yes	Yes	Yes	No	No	Yes	Yes	No	No	5 of 9
Slovakia	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	9 of 9
Slovenia	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	8 of 9
Spain	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	9 of 9
Sweden	Yes	Yes	Yes	Yes	No	Yes	Yes	No	No	6 of 9
United Kingdom	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	9 of 9
Codes including recommendation	27	23	27	16	14	27	24	9	6	

Notes: 1 the operation of the shareholder meeting and its key powers; 2 the description of shareholder rights and how they can be exercised; 3 the composition and operation of the board and its committees; 4 the shareholders holding major holdings, and their voting and control rights as well as key agreements; 5 the other direct and indirect relationships between these major shareholders and the company; 6 the existence and nature of a risk management system; 7 a reference to a code on corporate governance, designated for use at national level, with which the company complies or in relation to which it explains deviations; 8 disclosure of investment policy with respect to the exercise of voting rights in companies in which they invest; 9 disclosure to their beneficial holders at their request how these rights have been used in a particular case.

Source: own.

Table 1 covers recommendations focused on enhancing corporate governance disclosure (recommendation 1-9). The level of compliance of national codes is generally high as these recommendations usually serve as an opening chapter of the current codes. There are three topics which are implemented in every single code. Listed companies in all member states are now required to disclose the following topics: (1) description of the operations of the shareholder meeting and its key powers; (3) the composition and operation of the board and its committees; and (6) the existence and nature of a risk management system.

The most significant progress was made in case of recommendation 1, which in prior research required only 7 of 22 national codes. On the other hand, recommendations related to institutional investors (8 and 9), which aim to not only improve internal governance of institutional investors but also enhance their participation in the company governance, were and still are neglected. Although, institutional investors often disclose their own governance code, it would not be amiss if communication between company and its institutional investors was established in the national code. Especially, if we take into account the lasting growth of their importance in global ownership structure and their considerable role in the recent global financial crisis (e.g. Hawley *et al.*, 2011; Manconi *et al.*, 2012).

Table 2. Strengthening shareholder´s rights and modernising the board of directors

Individual member states	10	11	12	13	14	15	16	17	18	Recommendations in compliance
1	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*
Austria	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	8 of 9
Belgium	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	No	7 of 9
Bulgaria	Yes	No	No	No	Yes	Yes	No	No	No	3 of 9
Croatia	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	8 of 9
Cyprus	Yes	No	No	Yes	Yes	Yes	Yes	Yes	Yes	7 of 9
Czech Republic	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	7 of 9
Denmark	Yes	No	No	Yes	Yes	Yes	Yes	No	Yes	6 of 9
Estonia	Yes	No	No	Yes	Yes	Yes	Yes	No	No	5 of 9
Finland	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	No	7 of 9
France	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	8 of 9
Germany	Yes	Yes	No	Yes	Yes	Yes	No	Yes	Yes	7 of 9

1	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*
Greece	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	8 of 9
Hungary	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	No	7 of 9
Italy	Yes	No	No	Yes	Yes	Yes	Yes	No	Yes	6 of 9
Latvia	Yes	No	No	Yes	Yes	Yes	Yes	No	Yes	6 of 9
Lithuania	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	9 of 9
Luxembourg	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	8 of 9
Malta	Yes	No	No	Yes	Yes	Yes	Yes	No	Yes	6 of 9
Netherlands	Yes	No	No	Yes	Yes	Yes	Yes	Yes	Yes	7 of 9
Poland	Yes	No	No	Yes	Yes	Yes	No	No	No	4 of 9
Portugal	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	No	7 of 9
Romania	Yes	No	No	Yes	Yes	Yes	No	No	Yes	5 of 9
Slovakia	Yes	No	Yes	Yes	Yes	Yes	Yes	No	Yes	7 of 9
Slovenia	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	8 of 9
Spain	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	8 of 9
Sweden	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	8 of 9
United Kingdom	Yes	No	No	Yes	Yes	Yes	Yes	Yes	Yes	7 of 9
Codes including recommendation	27	10	7	26	27	27	23	18	20	

Notes: 10. Access the relevant information before the General Meetings; 11. shareholder democracy: the one share-one vote principle; 12. provisions for cross-border voting; 13. in areas of possible conflicts of interest, decisions should be made by non-executive directors; 14. disclosure of the remuneration policy; 15. disclosure of details of remuneration of individual directors; 16. prior approval by the shareholder meeting of share and share option schemes for directors; 17. proper recognition in the annual accounts of the costs of such schemes for the company; 18. collective responsibility of all board members.

Source: own.

Table 2 provides the results of the comparison of recommendations concerning strengthening shareholders' rights and modernising the board of directors. Again we can see that three recommendations 10, 14, and 15 are included in all examined national codes. Issue of relevant information before the General Meeting is linked with the recommendation 12 related to provisions for cross-border participation in the General Meeting (6 out of 27 codes). While there are only several national codes emphasizing the importance to allow foreign shareholders to actively participate during the general meetings, a majority of codes recommends to hold the general meeting at least partly electronically to ensure that the shareholders are able to participate without having to be physically present.

Only 10 codes explicitly call for a principle one share- one vote stated as the recommendation 11, but basically all the codes word that all shareholders within any share class of the same issue should have equal rights. The remaining recommendations show a rather high degree of compliance across the European Union.

Remuneration of top management and board members is a well discussed topic not only in business and academic circles. Astronomical salaries go usually unnoticed during a period of prosperity, because stock prices rise along with executives´ stock options and shareholders are pleased. However, when a recession, leading to the weaker company performance, hits, compensation of executives get on the agenda. Shareholders, but also media and general public, call against it, and governments discuss regulation. The global financial crisis was one of those events where remuneration system was proven to encourage the risky investments and marginalize long-term objectives (Kirkpatrick, 2009; Bartkowiak & Borkowski, 2014). Therefore, it is not surprising that all of the analysed codes address disclosure of the remuneration policy and remuneration for the individual board members.

4.1. Compliance of national governance codes with COM-284 and time evolution

Figure 1 presents an overall compliance of all compared codes with the recommendations of COM-284 and its evolution in time for 22 codes based on the prior research by Hermes *et al.* (2006, 2007). We can see a universal trend of national codes towards a compliance with the 18 selected recommendations of COM-284. The highest number of recommendations (17 out of 18) is included in the Spanish code followed closely by 4 countries with 16 recommendations. As you can see, the Czech code, which was in the prior analysis in the first place, retains the number of recommendations because its latest version was issued in 2004. The Romanian code, which was with only 3 recommendations in the last place in 2006, was revised in 2009 and improved significantly its contain.

By the end of the year 2013, all analysed EU member states (apart from excluded Ireland relying on UK governance code) has provided a national governance code for companies listed on respective stock exchanges. Therefore, we can state that the national codes have generally evolved over time and 26 of 27 codes include at least a half of the designated recommendations which are in accordance with the European Commission communication COM-284 from 2003. However, many of the included recommendations (such as the description of shareholder rights, the operation of the general meeting, responsibility of all parties) belong to the basic duties of incorporated companies and it is rather likely that the national company law require them directly. Even though still lacking in various areas, we can conclude that all current codes sufficiently covers main governance issues.

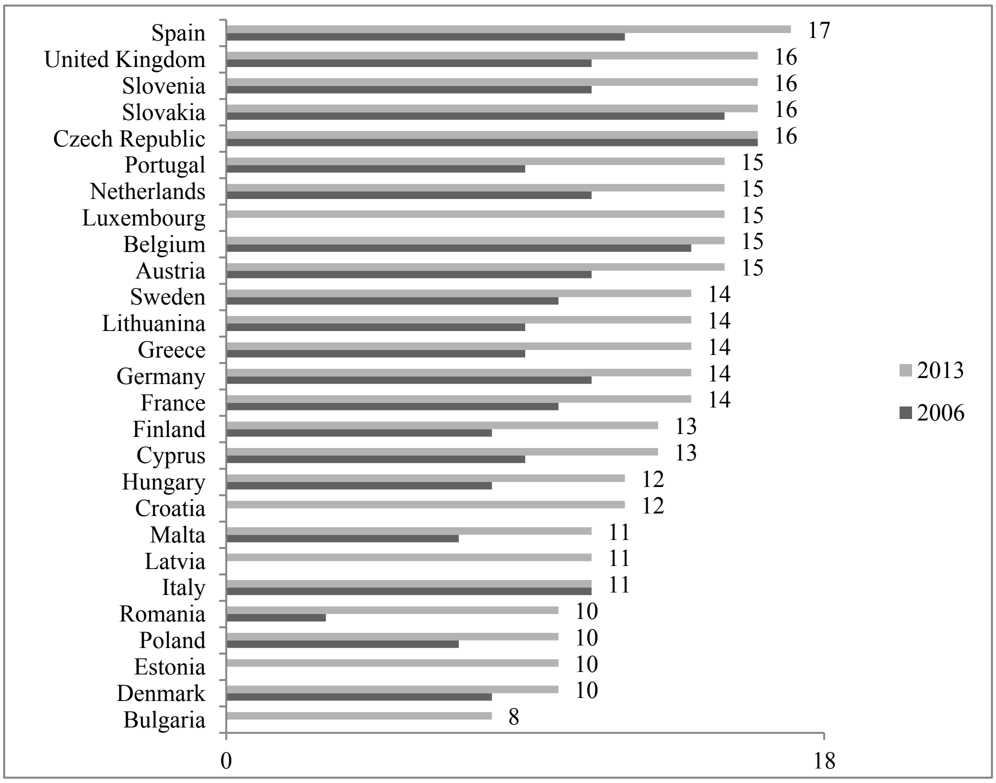

Figure 1. Overall compliance with COM-284 and its evolution in time
Source: own.

5. Implications and Recommendations

The issues of today's dynamic and often turbulent business environment cannot be treated by a single static code. In reactions to relevant issues, European Commission issued three sets of the following recommendations. As described above, these recommendations are focused on remuneration of board members and a role of non-executive members in governance mechanism.

Prior recommendations of COM-284 were supposed to mainly secure that remuneration policy is properly disclosed to shareholders and that they have a right to approve it at a general meeting. Two additional sets of recommendations have followed in 2004 and then 2009. Issues of remuneration are considered in some form in all codes however there is a particular variance in several details. Apart from Polish governance code that does not advice on remuneration policy, codes in EU recommend making remuneration granted to individual directors disclosed in detail in the annual accounts and submit the remuneration statement to the annual general meeting for a vote. Although, a majority of codes describes variable components of remunerations, many of them do not suggest to companies to set limits on these variable components. For decades, companies have tied executive compensation to equity, such as stocks and options and the variable component has become a predominant part of their salary. Limit represents one of potential mechanisms to keep executive remuneration within acceptable limits and at the same time keep them still motivated to pursue the objectives of shareholders.

After the recent crisis, remuneration system for executives and nonexecutives has once again become a subject of discussion. Another lacking area is remuneration for non-executive or supervisory board members where many of codes do not describe the manner of their compensation. The best practice presented in the EC recommendation suggests excluding share options from their remunerations. This measure stems from the non-executive director responsibilities towards shareholders and performance-based recommendation may lead to conflicts of interest.

Table 3. Remuneration policy

Individual member states	1	2	3	4	5	6	Recommendations in compliance
1	*2*	*3*	*4*	*5*	*6*	*7*	*8*
Austria	Yes	Yes	Yes	Yes	Yes	No	5 of 6
Belgium	Yes	Yes	Yes	Yes	Yes	Yes	6 of 6
Bulgaria	Yes	Yes	Yes	Yes	No	Yes	5 of 6
Croatia	No	Yes	Yes	Yes	No	No	3 of 6
Cyprus	Yes	Yes	Yes	Yes	Yes	Yes	6 of 6
Czech Republic	No	No	Yes	Yes	Yes	No	3 of 6
Denmark	Yes	Yes	Yes	Yes	Yes	Yes	6 of 6
Estonia	No	No	Yes	Yes	No	No	2 of 6
Finland	Yes	Yes	Yes	Yes	No	Yes	5 of 6
France	Yes	Yes	Yes	Yes	No	No	4 of 6
Germany	No	No	Yes	Yes	No	No	2 of 6
Greece	No	Yes	Yes	Yes	Yes	Yes	5 of 6
Hungary	No	Yes	Yes	Yes	No	Yes	4 of 6
Italy	Yes	Yes	Yes	Yes	Yes	Yes	6 of 6
Latvia	Yes	Yes	Yes	Yes	Yes	Yes	6 of 6
Lithuania	Yes	Yes	Yes	Yes	No	No	4 of 6

1	*2*	*3*	*4*	*5*	*6*	*7*	*8*
Luxembourg	No	Yes	Yes	Yes	Yes	Yes	5 of 6
Malta	No	No	Yes	Yes	No	No	2 of 6
Netherlands	Yes	Yes	Yes	Yes	Yes	Yes	6 of 6
Poland	No	No	No	No	No	No	0 of 6
Portugal	Yes	Yes	Yes	Yes	Yes	Yes	6 of 6
Romania	No	No	Yes	Yes	No	No	2 of 6
Slovakia	No	Yes	Yes	Yes	No	No	3 of 6
Slovenia	No	No	Yes	Yes	Yes	Yes	4 of 6
Spain	Yes	Yes	Yes	Yes	No	No	4 of 6
Sweden	Yes	Yes	Yes	Yes	Yes	Yes	6 of 6
UK	Yes	Yes	Yes	Yes	Yes	Yes	6 of 6
Codes including recommendation	15	20	26	26	14	15	

Notes: 1. If the remuneration policy includes variable components of remuneration, company should set limits on the variable components; 2. Award of variable components of remuneration should be subject to predetermined and measurable performance criteria. 3. the remuneration policy and any significant change should be an explicit item on the agenda of the annual general meeting and submitted to the general meeting for a vote; 4. total remuneration and other benefits (i.e. shares and/or rights to acquire share, pension schemes) granted to individual directors should be disclosed in detail in the annual accounts; 5. Shares should not vest for at least three years after their award; 6. remuneration of non-executive or supervisory directors should not include share options.

Source: own.

The last examined set of EC recommendation is dealing with the position of non-executive and supervisory directors and the committees under the board. Their main role is predominantly important in overseeing executive directors and top management, as they should be capable to resolve any potential conflicts of interests. Particularly beneficial for monitoring purposes is the presence of independent directors who are considered in agency theory as an efficient mechanism to protect the interests of shareholders and other stakeholders. The recommendation 8, which is in overall compliance across the European codes, stresses the importance of a sufficient number of independent board members in order to deal with the potential conflict of interest involving board members. However, since EC recommendations are benevolent in this respect and national governance codes can define their own definition of independence, it is expected that efficiency of this monitoring mechanism may vary in practice.

We can observe that besides several member states, governance codes provide listed companies with the recommendations in compliance with the Commission. Only exception is the recommendation 10 proposing that at least one of the members of the remuneration committee should have knowledge and experience in the field of remuneration policy. While this practice is a norm in case of audit committee, majority of codes do not specify qualification for the remuneration committees. This EC recommendation is evidently in line with previous recommendations directed at remuneration policy. It strengthens shareholders´ monitoring of remuneration for executive and non-executive directors, as qualified and independent committee member is capable to evaluate board and management performance and set adequate remuneration for individual members.

Table 4. Role of non-executive or supervisory directors of listed companies and on the committees of the board

Individual member states	7	8	9	10	11	12	13	14	Recommendations in compliance
Austria	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	8of 8
Belgium	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	7of 8
Bulgaria	No	No	No	No	Yes	Yes	Yes	Yes	4of 8
Croatia	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	7of 8
Cyprus	Yes	Yes	Yes	Yes	No	Yes	Yes	No	6of 8
Czech Republic	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	7of 8
Denmark	Yes	Yes	Yes	No	No	Yes	No	Yes	5of 8
Estonia	Yes	Yes	No	No	No	Yes	No	No	3of 8
Finland	No	Yes	Yes	No	Yes	Yes	Yes	No	5of 8
France	Yes	Yes	Yes	No	Yes	No	Yes	Yes	6of 8
Germany	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	7of 8
Greece	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	7of 8
Hungary	Yes	Yes	Yes	No	Yes	Yes	Yes	No	6of 8
Italy	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	8of 8
Latvia	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	8of 8
Lithuania	Yes	Yes	No	No	No	Yes	No	Yes	4of 8
Luxembourg	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	8of 8
Malta	Yes	Yes	Yes	No	No	No	No	Yes	4of 8
Netherlands	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	8of 8
Poland	No	Yes	No	No	No	Yes	No	No	2of 8
Portugal	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	7of 8
Romania	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	7of 8
Slovakia	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	7of 8
Slovenia	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	8of 8
Spain	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	8of 8
Sweden	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	8of 8
UK	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	7of 8
Codes including recommendation	24	26	23	11	21	25	22	20	

Notes: 7. the present or past executive responsibilities of the board's chairman should not stand in the way of his ability to exercise objective supervision; 8. a sufficient number of independent non-executive or supervisory directors should be elected to the board to ensure that any conflict of interest involving directors will be properly dealt with; 9. description of the nomination, remuneration and audit committees should make recommendations aimed at preparing the decisions to be taken by the board itself; 10. at least one of the members of the remuneration committee should have knowledge of and experience in the field of remuneration; 11. companies may group the functions as they see fit and if necessary create fewer than three committees; 12. the board should make public at least once year information about its internal organisation and ensure that shareholders are properly informed as regards the affairs of the company, its strategic approach, and the management of risks and conflicts of interest; 13. the code should describe appointment and removal of non-executive or supervisory directors; 14. the code provides profile of non-executive or supervisory director in terms of their qualifications, commitment, and independence.

Source: own.

6. Further Analysis

For possible further implications, we analyse data sample from the various perspectives. There are in total the 32 selected recommendations from COM-284 and three sets of recommendations issued by Commission. A number of recommendations in compliance, which are included in the individual governance codes, are combined.

Firstly, we divide codes into Western Europe and Central and Eastern Europe (CEE). Of course, such a division does not only reflect a geographical layout of the European Union but also other factors, such as development of national capital market being at the forefront of our analysis. Stock exchanges in the CEE are generally undeveloped with a small number of listed companies compared with the Western European markets. There are 16 Western and 11 Central and Eastern European member states. Average number of recommendations in compliance for the Western European countries is 25.69 out of the total 32, while for the CEE countries it is 21.36. T-test for two independent samples reveals that this difference of the overall average compliance between the two regions is statistically significant (sig .014). Results of this test suggest that the Western European codes are more complex and require higher level of transparency and disclosure from the listed companies than the national codes in the Central and Eastern Europe.

Secondly, we examine whether a reference of the national code to the Commission recommendations is an indication that these codes are in higher compliance with the priorities of the European Union or the proposed recommendations can be considered the best international practice and the national stock exchanges have implemented them independently of Commission intentions. There are 13 codes directly referring in the introduction to the European recommendations (Austria, Belgium, Bulgaria, Finland, Hungary, Latvia, Lithuania, Luxembourg, Poland, Slovakia, Slovenia, Spain, and Sweden). In this instance, average number of included recommendations is slightly higher for codes which refer to the Commission recommendations (24.31) compared to average number of 14 remaining member states (23.57). However, the difference is not statistically significant (sig .689).

To verify this result, we also examine the year when the national code was issued. Since the last set of the EC recommendations was published in April 2009, we examine whether codes revised since the second half of the year have more recommendations in compliance. There are 16 codes which were published after the second half of the year 2009 as you can see in full list in the Appendix. Again, the difference between these two groups is minor, the codes dated before 2009 have on average 24.36 recommendations in compliance, while the codes dates after 2009 23.63. T-test confirms that this difference is not significant (sig .693).

We can assume from these results that national stock exchanges as the code issuers are following the current best practice of corporate governance and they need not wait for the EC recommendations since these are already included in some form or other in their national versions. On the other hand, we can claim that codes issued after the recommendations of the European Union had an opportunity to properly implement the best practice through the latest sets of recommendations issued by internationally recognised organization.

Conclusion and Future Research

In this paper we have examined compliance of governance codes of the European Union member states with the recommendations proposed by the European Commission within an Action plan "Modernising Company Law and Enhancing Corporate Governance in the European Union". We have posited two research questions. First, we have examined whether exogenous forces in the form of the European Union have an impact on contain of national governance codes issued by respective stock exchanges. If so, we have anticipated convergence among these codes. While we have not been able to prove that national codes are directly influenced by the EC recommendations, high level of compliance across member states is indisputable (Western Europe 25.69, Central and Eastern Europe 21.36 of 32). Thus this convergence may be most likely attributed to exogenous forces that shape content of national governance codes. We assume that in earlier years of our timeframe such force represented OECD Principle of Corporate Governance (OECD, 2004) and especially first versions of CEE member states directly refer to them. Later, the global financial crisis has provided valuable lesson that has led to the additional strengthening of regulation.

Second, we have contributed to limited research analysing evolution of governance codes as we have asked whether the governance codes follow best practice and develop over time. As the starting point of our analysis, we employed findings of Hermes at el. from 2006 and compared them with the code compliance in 2013 as presented in Figure 1. During this timeframe we can observe a significant strengthening of codes quality across member states, as the vast majority is in line with European Commission in more than half of the proposed recommendations. Also we have confirmed previous findings, that countries with more developed capital markets need more advanced recommendations.

For the future development of corporate governance framework in the European Union, we expect that the European Commission will proceed with proposed intentions commenced in 2003. The latest EC document related to corporate governance is the communication COM-740 entitled "Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies" published in December 2012 (European Commission, 2012). Ten years have passed since the action plan was initiated in 2003 and many objectives were successfully achieved through directives or recommendations. It was therefore necessary to establish new goals in the area of company law and corporate governance. From the document is clear that EC is more concerned about the harmonization in the form of directives than voluntary recommendations. Only non-legislative initiative which the Commission intended to address was to improve the quality of corporate governance reporting in the form of a recommendation (2014/208/EU) and in particular the quality of explanations which should be provided by listed companies that depart from the governance code provisions. The reason is that quality of the corporate governance reports produced by listed companies has been subject to criticism because listed companies often provide insufficient explanations for their deviation from governance code applied on a "comply or explain" basis. This latest contribution to soft-law regulation of the EU was published in 2014.

Limitation of this paper stems from the very nature of codes as a voluntary set of recommendations. Although, code enforceability in our study is ensured by selecting only codes issued by the national stock exchange regulator or appropriate authority, a principle "comply or explain", which is a keystone of the governance codes, is the problematic part of the study. There are legitimate doubts about actual efficiency of the "comply or explain" principle to establish best corporate governance practices. According to RiskMetrics Group Study (2009), more than 75 percent of the investors across Europe including institutional investors support this principle that is the core of all European governance codes and consider soft-law regulation to be effective regulatory tool. Listed companies do not have to comply with the recommendations as long as they provide some explanation for this deviation. However, a study by RiskMetrics Group (2009) for the European Commission reveals that companies mostly provide only a very general explanation which basically renders code recommendations worthless. Additionally, this principle empowers shareholders to make an informed evaluation based on company explanation of non-compliance. However, in case of weak shareholder activism, there is no mechanism to assess company statements by regulatory body and ensure compliance with recommendations in practice (Keay, 2014). Strictly speaking, we cannot draw conclusions about corporate governance quality of listed companies entirely from the number of recommendations in compliance with the European Union included in the national code.

While, we can observe certain shift of focus to hard-law regulation at the EU level, it is important to study how both forms of regulation can efficiently help to establish sound corporate governance. With growing literature, we can see evidence that soft-law is not always sufficient in order to improve corporate practice, as we explained above. This is the case mainly in transition and emerging economies where existing institutional environment reflects in weak investor rights, poor law enforcement and undeveloped capital market. Even the most progressive governance code in such countries does not necessarily improve existing practices (Chen *et al.*, 2011; Cuomo *et al.*, 2015). For this reason, future research should address a link between recommendations included in national governance code, the quality of institutional environment and overall company compliance.

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